PACIFIC FUNDS insights

OCTOBER 2021

BIG TECH + BIG REGULATION = OPPORTUNITY?

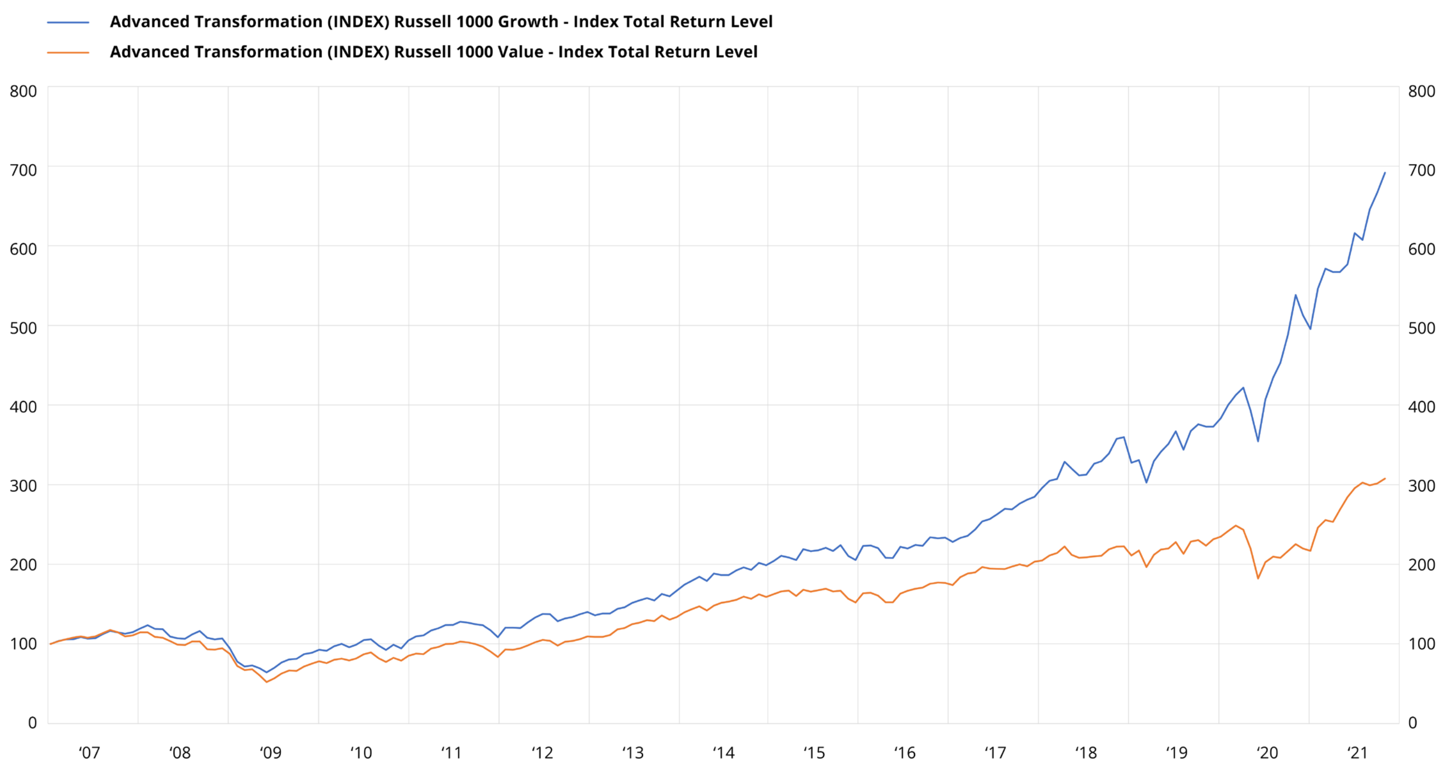
As regulators set their sights on Big Tech, will large-cap value stocks emerge a winner?

By Samuel Park, Director of Fundamental Research, Pacific Life Fund Advisors

Key Takeaways

- For decades, Big Tech companies have flourished with little regulation, while large banks were hemmed in by legislation enacted in 2010 in the wake of the Great Financial Crisis.
- Now regulators, both foreign and domestic, have begun to turn their sights on Big Tech and what they perceive as monopolist practices.
- Increased oversight on the tech giants and any resulting legislation may generate significant headwinds for companies such as Google, Apple and Facebook.
- This regulatory shift may provide a chance for large-cap value stocks to outperform large-cap growth stocks over the medium term.

Since the Great Financial Crisis of 2007-2008, large-cap growth stocks (as measured by the Russell 1000 Growth Index) have outpaced large-cap value (Russell 1000 Value), especially over the past five years. Much of large-cap growth's robust performance can be attributed to Big Tech, while the financial sector largely represents large-cap value.



Source: FactSet as of 8/31/21

Regulatory policies—or lack thereof—may have influenced how growth stocks performed relative to their value counterparts. Weak regulatory oversight allowed tech giants to flourish with little regulatory hinderance, while large banks were burdened by restrictions set by the Dodd-Frank Act of 2010, which overhauled financial regulation following the Great Financial Crisis.

But the tide may be turning. Over the past decade, banks have largely adjusted to the increased oversight, and now it's Big Tech's turn under the regulatory microscope. Policy makers around the globe have passed—or are considering—laws to rein in what they see as Big Tech's unchecked anticompetitive practices. In our opinion, this has the potential to be a catalyst that shifts momentum in favor of value stocks over growth ones.

Headwinds of Regulation

Antitrust regulations may create more even playing field; however, historically they also ushered in a period of slower growth for the targeted company. For example, in 1998, Microsoft faced off against the U.S. Department of Justice over antitrust issues. Initially, a federal district court ruled that Microsoft's actions were monopolistic and ordered the company broken up. Eventually, Microsoft agreed to change its practices and settle the case. Nevertheless, the legal distraction was enough to hamper the tech giant's ambitions, which was reflected in its stock performance over the following decade that was relatively flat throughout the bull market of 2003-2007.

Source: FactSet as of 12/31/07

Foreign Pressure

So far, foreign counties have been the most aggressive in putting regulatory pressure on U.S. Big Tech companies. South Korea's parliament recently passed a law that forces Apple and Google to allow app developers to use alternative payment systems. This effectively limits those companies from charging high commissions on in-app purchases. Although South Korea alone will not materially hurt Apple and Google, this action may motivate others to follow suit. Recently, the Competition Commission of India announced that it will soon be examining a similar investigation related to in-app payment systems.

European regulators have already started bombarding U.S. tech giants with antitrust laws. European Union antitrust regulators are also investigating Apple over its App Store and mobile payment system Apple Pay.

Then there is Facebook's uncertain future internationally and domestically. UK antitrust officials are seeking to force Facebook to unwind its acquisition of Giphy, a provider of popular animated images. Before Giphy was acquired by Facebook, its own paid advertising business in the U.S. had the potential to compete with Facebook's advertising services. The acquisition effectively removed a potential challenger in display-advertising markets. Now, Facebook will be burdened with fighting the provisional decision to sell off Giphy, arguing the validity of a British regulator having the ability to enforce a global order.

Crackdown by U.S Regulators

Last year, the U.S. Department of Justice (along with 11 states) filed a civil antitrust lawsuit against Google, accusing it of exclusionary practices in the search and search-advertising market. According to the complaint, Google was used for nearly 90% of search queries in the U.S. and employed anticompetitive tactics by being the preinstalled search engine on billions of mobile devices and computers. At the same time, the lawsuit alleged, Google entered into agreements that prohibit the preinstallation of a competitor. If that wasn't enough, the complaint also stated that Google used monopoly profits to buy preferential treatment for its products and services to create a self-reinforcing cycle of monopolization.

Google was hardly the regulators' only Big Tech target. Facebook has been accused of eliminating competitors by buying companies such as Instagram, WhatsApp and Giphy to create a dominant and sustainable social-networking ecosystem.

Lina Khan, the new chair of the Federal Trade Commission, has been very vocal about her concerns that Big Tech giants such Facebook and Amazon have gained too much influence in recent years. This will likely mean that U.S. regulators will increase their scrutiny over Big Tech companies.

New Legislation Targets Big Tech

President Biden's push for pro-competition reform could give regulators more ammunition to topple Big Tech's market dominance, and laws enacted overseas could provide a blueprint for U.S. policymakers.

This summer, congressional lawmakers introduced a set of bills aimed at constraining Big Tech. The bills, if passed into law, would represent a material change to antitrust policies. If enacted:

- They would make it easier to scale back businesses that leverage their dominance to gain a stronghold in another business segment.
- The bills would create new barriers for acquisition of nascent peers.
- They would provide more funding to enforce these laws through higher merger fees.

This would mean Facebook and Google will have a tougher time growing through acquisitions. Facebook has thrived, in part, by acquiring new technology and talent. Forbidding acquisitions would weaken Facebook's grip over personal data, which is Big Tech's most precious commodity. Furthermore, companies such as Apple may lose its gatekeeper role in the distribution of apps and content to users of Apple devices.

Conclusion

For years, a few Big Tech companies have dominated their respective markets with minimal regulatory burden. However, the regulatory environment has now become more hostile, which can be a material distraction for those companies.

There was the saying in the investment world: “Don’t fight the Fed.” Perhaps this time around it will be, “Don’t fight the regulators.” It’s impossible to say whether Big Tech goes to battle with regulators or, like Microsoft decades ago, looks for compromise. Either way, the regulatory fever may weaken large-cap growth, allowing large-cap value—long accustom to heavy regulation—to potentially regain the lead over the medium-term.

For more insights from Pacific Funds, visit

PacificFunds.com

Disclosures:

The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. You cannot invest directly into an index.

The **Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-value ratios and higher forecasted growth values. You cannot invest directly into an index.

Holdings are subject to change at any time. Please visit **PacificFunds.com** for a current listing of fund holdings.

About Principal Risks: Past performance does not guarantee future results. All investing involves risks including the possible loss of the principal amount invested. There is no guarantee the Funds will achieve their investment goal. Corporate bonds are subject to issuer risk in that their value may decline for reasons directly related to the issuer of the security. Not all U.S. government securities are checked or guaranteed by the U.S. government, and different government securities are subject to varying degrees of credit risk. Mortgage-related and other asset-backed securities are subject to certain rules affecting the housing market or the market for the assets underlying such securities. The Funds are subject to liquidity risk (the risk that an investment may be difficult to purchase, value, and sell particularly during adverse market conditions, because there is a limited market for the investment, or there are restrictions on resale) and credit risk (the risk an issuer may be unable or unwilling to meet its financial obligations, risking default). High-yield/high-risk bonds ("junk bonds") and floating rate loans (usually rated below investment grade) have greater risk of default than higher-rated securities/higher-quality bonds that may have a lower yield. The Funds are also subject to foreign-markets risk.

Pacific Life Fund Advisors LLC is the manager of the Pacific Funds Portfolio Optimization Funds. The views in this commentary are as of Sept. 25, 2021 and are presented for informational purposes only. These views should not be construed as investment advice, an endorsement of any security, mutual fund, sector or index, or to predict performance of any investment. Any forward-looking statements are not guaranteed. All material is compiled from sources believed to be reliable, but accuracy cannot be guaranteed. The opinions expressed herein are subject to change without notice as market and other conditions warrant.

Past performance does not guarantee future results. All investing involves risks including the possible loss of the principal amount invested. High-yield/high-risk bonds ("junk bonds") and floating-rate loans (usually rated below investment grade) have greater risk of default than higher-rated securities/higher-quality bonds that may have a lower yield. Corporate bonds are subject to issuer risk in that their value may decline for reasons directly related to the issuer of the security.

Pacific Life Insurance Company is the administrator for Pacific Funds. It is not a fiduciary and therefore does not give advice or make recommendations regarding insurance or investment products.

Investors should consider a fund's investment goal, risks, charges, and expenses carefully before investing. The prospectus and/or summary prospectus contains this and other information and should be read carefully before investing. The prospectus can be obtained by visiting PacificFunds.com.

Pacific Funds are distributed by **Pacific Select Distributors,** LLC (member FINRA& SIPC), a subsidiary of Pacific Life Insurance Company (Newport Beach, CA), and are available through licensed third parties. Pacific Funds refers to Pacific Funds Series Trust.

Mailing address:
P.O. Box 9768, Providence, RI 02940-9768
(800) 722-2333 • www.PacificFunds.com